

LETTER FROM THE | EXECUTIVE DIRECTOR



The Commission and staff are pleased to release this Annual Report on the Massachusetts Public Retirement Systems for 2014, a year in which public pension systems made marked progress towards enhancing their long term fiscal soundness. Building on the success in overcoming the investment losses suffered in 2008, retirement boards have adopted more conservative investment assumptions, updated mortality tables and addressed new accounting standards.

Unfortunately, as we overcome one set of challenges new threats to the stability and professionalism of the retirement system have arisen. There is now an effort to weaken the governance reforms embodied in Chapter 176 of the Acts of 2011. The procurement provisions of the statute mandating regular due diligence competitive searches, disclosure of secret payments made in connection with the vendor selection process, and transparency with respect to the basis of board decisions have increased confidence that retirement board decisions are made without undue influence.

In last years' Report I noted that because of the willingness of retirement board members to greet major change with calm and cooperation, concerns about procurement practices, educational standards, and transparency that have contributed to the clamor for the destruction of the Massachusetts' public pension funds and the repeal of benefits available to public employees in the Commonwealth, had abated. Any retreat from the very reforms that were the basis of this optimism represents a grave danger to the system's viability.

COMMISSION/STAFF CHANGES

As noted in last years' Report the retirement community was deeply saddened by the loss of PERAC Chairman Dominic Russo. The Judge's steady leadership and warm smile helped the Commission through many challenges.

Commissioner Phil Y. Brown was elected Chairman of the Commission in the wake of the Judge's passing. He is a prominent Boston attorney and served as Chairman of the Special Commission on Group Classification.

Chairman Brown has proven to be a thoughtful, dedicated and knowledgeable leader and we look forward to working with him in the years ahead.

Other changes on the Commission were the appointment of Kate Fitzpatrick as the MMA representative. Kate replaced former Arlington Town Manager Don Marquis, one of the original members of the Commission. Don provided insight and brought his years of local experience to the issues confronting the retirement community. He was a staunch advocate for fully funding pension and health care liabilities and his penetrating questions kept PERAC staff on their toes.

Kate is no stranger to retirement issues as she has served on the Needham Retirement Board and on the Special Commission to Study the Contributory Retirement System. Presently she is the Town Manager of Needham and has served at the local and state level for over two decades. Her experience has already assisted the Commission in its corporate governance and internal management.

Earlier this year Governor Deval Patrick appointed Elizabeth Fontaine to the Commission to fill the vacancy created in the "investment" seat by the selection of Commissioner Brown as Chairman. Commissioner Fontaine serves as Assistant Executive Director of the Massachusetts Educational Financing Authority (MEFA). At MEFA she has spearheaded the development of the Commonwealth's programs to assist parents and students in meeting the costs of higher education. Commissioner Fontaine is the PERAC expert on matters related to finance and investment. The Commission has already tapped that knowledge base with respect to several pension financing issues.

Staff changes took place during the year as PERAC Director of Information Technology Paul Laliberte retired after sixteen years of leading PERAC's technology efforts. Paul's dedication and professionalism ensured that the Commission remains at the forefront of technological innovation and that the use of technology in the retirement context would be maximized. In particular Paul maintained PERAC's systems and upgraded software and hardware resulting in the ability to efficiently process information, communicate with our constituencies and operate at the highest levels of performance.

In the wake of Paul's departure Dan Boyle has been appointed Information Technology Director. He comes to us with over 19 years of IT experience most recently serving as IT Director at the Executive Office of Education. In his new position Dan has initiated a systematic review of the PERAC IT environment, upgrading security features and improving ease of use for PERAC staff.

Other staff changes included the departure of Auditor Jim Ryan who has assumed the position as Executive Director of the Malden Retirement Board. Auditor John Shea moved on to the Norwood Retirement Board and receptionist Joan Arsenault retired. We wish Jim and John well in their new endeavors as well as the best to Joan in her retirement. Michael Pasternak was hired to augment the Audit Unit in the wake of these departures and Patricia Tanso filled Joan's position. Other staff additions have included Cheryl Johnson as Compliance Analyst. Cheryl is a Chartered Financial Analyst who has previous experience in the investment industry. She works with Compliance Officer Tom O'Donnell and Compliance Counsel Derek Moitoso.

CHINESE DELEGATION

In August of 2014 a delegation of twenty three senior officials from the Chinese province of Zhejiang visited PERAC to discuss the workings of the Massachusetts' public pension system. PERAC staff made presentations about the agency's mission, history and management structure as well as its functions and responsibilities.

The importance of fiduciary duty in the management of pension plans and the role of regulatory oversight were explored. Finally a short course in Actuarial Basics was presented.

China and its provinces are in the early stages of reassessing the retirement system in the country as it moves to a more market based economy.



Joe Connarton addresses the Chinese Delegation from the province of Zhejiang.

EMERGING ISSUES FORUM

PERAC held its Tenth Emerging Issues Forum at the College of the Holy Cross in September 2014. Over two hundred and seventy-five people participated as board members attending received three educational credits. Opening remarks by Treasurer Steve Grossman congratulated the Commission for its decade of interesting and informative sessions. The Treasurer was well received as he addressed a variety of topics including pension reform, the record of the PRIT Fund and the importance of maintaining defined benefit retirement systems. He concluded by thanking the retirement community for its support and professionalism throughout his term in office. A centerpiece of the Forum was an extensive discussion of recent accounting pronouncements by the Governmental Accounting Standards Board (GASB). That Board has published GASB Statements 67 and 68 which effect how local governments report pension liabilities and expenses. Across the country pension funds, accountants and actuaries are grappling with the need to meet these new standards. The first panel included PERAC Actuary Jim Lamenza, Bill Connolly of Segal, David Driscoll of Buck Consultants and Larry Stone of Stone Consulting. That part of the program began with a Why, What, When and Who of GASB 67 and 68 providing a general overview of the new reporting guidelines. Details relative to dates and timing as well as the need to coordinate the statements of the pension plan and the statements of the plan sponsor were reviewed. This session concluded with a discussion of cost-sharing plans and their treatment under GASB 67 and 68. The second GASB panel included Linda Bournival of KMS Actuaries, Frank Biron of Melanson Heath and Brock Romano of KPMG. This group focused on planning, preparation and

collaboration necessary for implementation of the standards as well as “best practices”. The final topic covered focused on the audit implications pertaining to testing of census data.

Secretary of State William Galvin gave the keynote address of the Forum. The Secretary reviewed the issue of securities regulation as it pertains to pensions and retirement. His office oversees the activities of broker-dealers and agents, investment advisers and investment adviser representatives. His presentation included a discussion of abuses in the offering of securities for sale and providing investment advice investigated by his Securities Division. Secretary Galvin concluded his remarks by congratulating the Commission on its efforts to enhance transparency in the investment of public pension funds.

The Forum concluded with a panel focused on Understanding Investor Adviser Registration and Private Fund Due Diligence. Attorneys Daren Domina and Heather Wyckoff from Haynes & Boones were joined by Michael Garrity of the SEC’s Boston office and PERAC Compliance Counsel Derek Moitoso. The intricacies of registration, the due diligence resources available to investors and the importance of oversight of fund expenses were emphasized. Ms. Wyckoff entertained the attendees with a recitation of some of anecdotes regarding some expenses that general partners had attempted to charge to the fund.

For the tenth year this excellent program informed and educated retirement board members, administrators, actuaries, attorneys, investment professionals and other attendees. The second decade of these Forums will kick off on September 17, 2015 at Holy Cross.



Treasurer Steve Grossman gives opening remarks at the 10th Emerging Issues Forum.



Keynote speaker Secretary of State William Galvin addresses the Forum.



GASB 67/68

PERAC's Emerging Issues Forum provided an overview of the implications of new promulgations by GASB on the retirement systems. It is important to remember that Statement 67 and Statement 68 affect financial reporting for pension plans. GASB 67/68 do not impact plan funding but relate solely to accounting and financial reporting.

This represents an effort to ensure standardization in financial reporting. The focus is on measuring plan liabilities, plan assets, asset allocation, pension expense and other related items.

The key in meeting these requirements is collaboration among various parties including the retirement board, employer, actuary, auditor (both plan and employer), and investment consultant.

The retirement board's responsibilities include assuring the completeness and accuracy of the census data and a fair presentation of the plan financial statements and investment policy.

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The actuary's responsibilities include the actuarial valuation and determination of GASB 67/68 liabilities such as the pension expense, net pension liability, and the schedule of changes in net pension liability.

The investment consultant's responsibilities may include documenting target allocations and expected rates of return by asset class and the

calculation of the money weighted rate of return. For retirement boards invested in the PRIT Fund, PRIM will provide much of this information.

The plan auditor's responsibilities, if an independent plan audit is conducted, include an audit of the plan financial statements, testing accuracy of census data, and testing footnote information.

The employer's auditors' responsibilities include the audit of the employer financial statements and the determination of the appropriateness of the new disclosures.

Although meeting these standards is a challenge for the retirement boards and staff, we are hopeful that by working together compliance will be universal.

WEB SITE

PERAC's Communications Unit is hard at work transitioning our current web site to the Mass.gov portal. The goal of the new website is to make information easier to locate, modernize technology, and migrate to a platform that will be continuously updated. Working with the Unit is a team of web designers and usability experts from Mass.gov.

Part of the redesign with the site is to rethink the website itself from a catch-all of everything published by PERAC to a platform for disseminating newer and more current information. With that in mind, once we transition to the new site; we will no longer house every Memo and Annual Report as older documents will be available on site or on the state library's website.

PERAC has taken the comments of retirement board members and administrators into account in deciding how to best organize the site, but if you have further suggestions, contact the Communications Director at nadunker@per.state.ma.us.

LEGAL ISSUES

PERAC has prevailed at the Massachusetts Appeals Court in the case of PERAC v. David Madden et al. The Court agreed with the Commission that Madden having last performed the duties of Mayor, a Group 1 position prior to his retirement should be retired from that Group rather than Group 4. David Madden had served as a Weymouth firefighter, and later was appointed Fire Chief. While serving as Fire Chief he was elected Mayor and ultimately served two terms, having taken a leave of absence from the Chief position. According to Civil Service law he was entitled to be reinstated as Fire Chief at the conclusion of his service as Mayor. As his second mayoral term was ending he sought reinstatement as Fire Chief. Under an agreement with his successor and the existing Fire Chief, Madden was purported to be reinstated following a voluntary two day demotion of the incumbent. He then sought a superannuation retirement under group 4. The Weymouth Retirement Board approved that application however, PERAC rejected the Board action asserting that Madden should be retired under Group 1 as the last duties he performed were those of Mayor.

The Appeals Court concluded:

A person voluntarily assuming a position of elevated authority but diminished retirement benefits must abide by that choice.

The decision was not appealed further and is now final.

In another closely watched case regarding excess earning the Commission has once again prevailed in the matter of former Medford firefighter Paul Conway. Conway, a 50% owner of a roofing company, received a disability retirement in 2001. Prior to receiving the retirement allowance he had transferred his interest to his wife. Acting on a tip asserting that Mrs. Conway did no work for the company and that the ownership transfer was designed to avoid the earnings limitations in the statute, the Commission initiated an investigation in 2010. PERAC determined Conway had earnings above the allowable limit for years 2004-2007 requiring a refund to the system of \$154,237, the amount of his retirement allowance paid in the period. In 2011 the Medford Retirement Board determined that, in its view, Conway had no excess earnings. PERAC rejected that assertion and

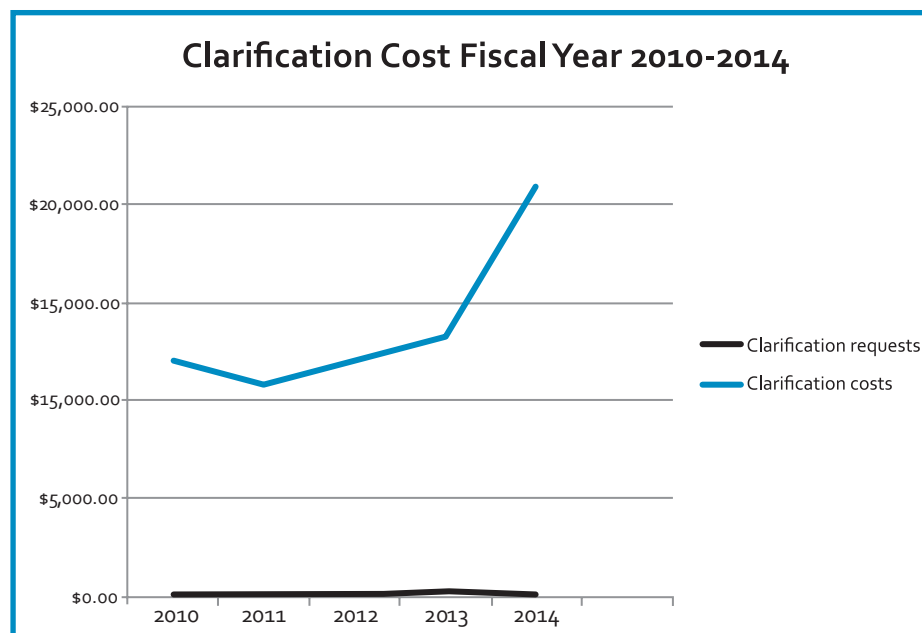
Medford appealed. DALA upheld the Commission position. The case proceeded to the issue of the level of earnings and penalty. DALA ruled that Conway had a significant role in the business; the wages he was paid did not reflect his contribution; Mrs. Conway's role was limited to administrative matters; and her work did not substantially contribute to the company's profits by focusing on the "fair value" of labor rather than the wages paid.

In making the decision the Magistrate relied on the case of Steere v. Dukes County Retirement Board and PERAC CR-09-312 which held that income from a spouse's ownership in a business may be attributable to a retiree for purposes of calculating excess earnings under Section 91A where the retiree's labor, management, or supervision contributed to that income.

Conway has appealed the case to the Contributory Retirement Appeals Board.

MEDICAL PANEL CLARIFICATIONS

Since inception the Commission has processed and, in certain circumstances encouraged, retirement boards to seek clarifications from medical panels when warranted. However, as the accompanying chart underscores, the expense associated with these requests has increased dramatically in the last few years. PERAC has prepared regulations for filing that attempt to maintain the integrity of



the medical panel process while making certain that such clarification requests are relevant and medical in nature. It was not that long ago that the disability benefits available under Chapter 32 were in jeopardy because of assertions that the cost was too great and the review process biased toward approval of the application. Reforms in the medical panel process adopted several decades ago established confidence that reviews would be comprehensive, fair and objective. We must work together to avoid reigniting the controversy over the manner in which disabilities are approved so that the benefit structure will remain intact.

Fiscal Year	# of Requests	Cost
2010	199	\$12,050.00
2011	178	\$10,825.00
2012	189	\$12,125.00
2013	239	\$13,225.00
2014	191	\$20,850.00

CONCLUSION

The year 2014 was a year when the retirement systems returned to a sense of normalcy following nearly a decade of pension reform, capital markets uncertainty and public skepticism. Investment returns again generally mirrored the markets and the experience of the retirement boards peers around the country. Progress in actuarial soundness, expanding the educational opportunities for board members, and administrative improvements have, for the moment, stalled what seem to be endless cries for dismembering our retirement system and gutting retirement benefits.

Some disturbing trends, particularly with respect to efforts to neuter governance reforms that

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have been the foundation of improving the public image of our pension system, threaten this progress. It would indeed be a shame if after weathering the storm of capital collapse, fiscal strain and public controversy these efforts reignited the movement to destroy what so many have fought to maintain.

The record of fiscal prudence, compassionate administration and steady stewardship reflected in these pages has been a counter to this negativism. Let us work together to expand on this record

and put to rest once and for all the movement to restructure the system and radically change the benefits available to our members and their beneficiaries.

Sincerely,

Joseph E. Connorton

Joeseeph E. Connorton
Executive Director